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PRACTITIONERS' CORNER

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Two decades after its last tax reform, the San Marino government has identified the reform of its tax regime as one of its main priorities.

San Marino needs higher revenues that can guarantee a balance between public finance and keeping the welfare state. The country also must focus on the tax system's competition, equity, and efficiency in order to proceed with a broader project aimed at redefining a new development model for the country.

Rethinking the regulatory framework of the tax levy may pave the way for the San Marino economy to advance; the current regime has been diminishing the growth of the country's economy and breeding a climate of uncertainty for the future.

San Marino has been intensely active in the last two years in aligning its tax rules to the standards of transparency of information agreed to by the international community, and amendments to the country's current tax system are urgently needed.

The Tax Reform Proposal

Preliminary Analysis

Recent tax reforms in other countries have common elements:

- the alignment, now a definite precondition, of national tax systems to a relational context characterized by actual transparency, effective cooperation among the states through the exchange of information, fair competition, and compatibility of international principles; and
- the adoption of widespread and well-established equity standards in the distribution of the tax burden, consistency and efficiency regarding administrative assessment, and the exercise of auditing authority.

The approach to the study and development of proposals for San Marino's tax reform has been structured along the following guiding principles:

- *Context*: The analysis carried out has allowed the identification of the socioeconomic dimension within which the San Marino tax reform may be positioned.
- *Method*: The approach based on comprehensive analysis of the aggregate structure of the San Marino tax revenue (historical and present) has allowed the identification of critical aspects of the present tax regime.
- *Merit*: The analysis performed has allowed the identification of specific intervention areas of the reform and, as a consequence, the possibility to develop technical implementation tools.

Economic Development Trends

The regulatory structure is no longer in a position to meet those efficiency and equity needs felt by the state and the people at large. In San Marino, the number of economic operators has notably increased, and along with the traditional sectors of the economy (industry, tourism, and commerce), the financial and services sectors have undergone a significant development; accordingly, the country's economy has grown increasingly

complex. Also, employment in San Marino has developed, and the number of cross-border workers has grown exponentially. The choice of a tax policy, as a result, affects not only residents but also a large number of nonresidents.

In general:

- The national tax policy of single countries is no longer limited to internal effects but is ranked within an international context in which transparency and cooperation are the necessary standards toward the realization of a balanced economic development. The choice falling on a particular tax policy is subject to compliance with those standards.
- The development of economic relations among the various states is increasingly linked to the existence of international agreements to ensure transparency for tax purposes so that double taxation might be eliminated. Thus, the national tax system must be aligned with international conventions.
- Tax competition is assessed on the basis of different parameters. Nominal tax differential and privacy are no longer the sole prerogatives of competitiveness.

Throughout 2009 signs of the global economic crisis clearly showed on the San Marino economy: The general slump of trade exchanges resulted in a reduction of the demand for services and products offered by San Marino enterprises. The effects of the international crisis have not yet been surmounted and have been impeding the recovery of all advanced economies.

Economic relations with Italy, San Marino's primary business partner, have become strained because of the absence of an income tax treaty[1] and of unilateral Italian provisions (in particular, San Marino's inclusion on the so-called ''blacklist'') that have contributed to the standstill of economic growth.

The economic downturn has led to the contraction of income for enterprises, the rise of unemployment, and the imbalance of public accounts, deriving from the decrease in revenues.

Within that backdrop, the debate in the country — regarding the tax levy's equity and efficiency — has become exacerbated. In view of the contraction of the revenue and the consequent imbalance of public accounts, structural revisions of the tax system are indispensable in order to recover revenues from those areas with low or insufficient taxation. Part of that inefficiency of the system is attributed to ''equity defects'' in the tax treatment.

[1]In June 2009 the protocol for the amendment to the Italy-San Marino treaty was initialed. The protocol includes the 2005 version of article 26 of the OECD model.

Events Foreshadowing the Reform Proposal

The reform project adds the finishing touch to the accomplishments already achieved by San Marino in prior legal provisions.

During the negotiations for the stipulation of a cooperation agreement in financial matters, negotiations for amendments to the Italy-San Marino income tax treaty (signed in 2002 but not entered into force yet) led each side, in June 2009, to initial a final text.

In 2009 San Marino, under the OECD guidelines, decided to hasten its cooperation in international tax matters to be fully included among cooperative jurisdictions.[2] This led to the signing, on August 1, 2011, of approximately 35 agreements (income tax treaties and tax information exchange agreements) based on the OECD 2005 model treaty and on the OECD's 2002 TIEA model.

For the application of the international tax cooperation agreements to become effective (and operative), article 36 of Law No. 165 of November 17, 2005, Law on Corporations and on Banking, Financial, and Insurance Services (Legge sulle Imprese e sui Servizi Bancari, Finanziari e Assicurativi), was amended to align it with international transparency standards.

In 2009 San Marino accelerated its alignment to international standards in the fight against money laundering and the financing of terrorism. These efforts allowed the country to exit from the reinforced procedure imposed by the MONEYVAL[3] and to obtain a favorable evaluation by the Financial Action Task Force.

In Decree-Law No. 190 of November 29, 2010, ratified through Decree-Law No. 36 of February 24, 2011, San Marino adopted further measures to implement provisions that would consent the effective application of agreements already signed as well as of those to be signed with other countries.

In Decree-Law No. 144 of August 6, 2010, ratified with Decree-Law No. 172 of October 26, 2010, San Marino adopted measures that will:

[2]Before April 2, 2009, the publication date of the first OECD progress report, San Marino had not signed any tax information exchange agreements, although it had signified its commitment in 2000. Therefore, the country had been included on the ''grey'' list. On July 14, 2009, San Marino and Belgium signed the amendment protocol to the income tax treaty, intervening precisely on the rules governing the exchange of information contained in the relevant article 27, which was modified on the basis of article 26 of the OECD model (2005 version). From then on, San Marino hastened negotiations in progress with other countries. According to the September 25, 2009, progress report, San Marino reached the minimum number of 12 TIEAs and moved from the ''grey'' to the ''white'' list.

[3]MONEYVAL is the abbreviated term for the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism.

- support the economic system;
- promote local enterprises;
- facilitate the launching of new business activities and thus motivate new investments;
- increase tax revenues deriving from direct taxation without interfering with nominal taxation, while concentrating the levy on areas that are ''tax-exempt'' or ''insufficiently taxed''; and
- improve the degree of efficiency regarding the relationship between the tax authorities and taxpayers, as well as the effectiveness of controls carried out by the tax office.

From a corporate law perspective, in order to optimize and achieve greater transparency of its tax system, San Marino radically reformed:

- the rules on having due cognizance of actual corporate structures of companies incorporated under the country's laws (Law No. 98 of June 7, 2010); and
- the procedures relating to the issue of licenses (Law No. 129 of July 2010).

'Competitiveness and Transparency'

Until 2008 San Marino attracted many foreign investors (especially from Italy) because of two prerogatives:

- a competitive tax system, with special reference to the most important European economies; and
- a marked confidentiality involving both investments in the financial area (bank secrecy) as well as in the entrepreneurial area (no information exchange, corporate anonymity).

The swift course of action during 2009-2010 toward transparency has changed the traditional prerogative of the confidential nature of San Marino's economic system.

Although privacy still has a place in financial matters, it must be downsized in order to be aligned with international norms.

The signing of treaties and TIEAs create conditions so that only substantial and actual business activities may be considered exempt from transnational tax litigation involving tax residence issues.

The absence of adequate amendments to the tax regime might mean the inability to attract foreign investments in the future. The increasing rigidity, at an international level, of measures intended to counter tax evasion and the flight of capital significantly influence the choices of entrepreneurs who might be considering foreign investments: Privacy, at this particular economic point in time, has assumed a much higher value regarding tax savings.

San Marino must be able to avail itself of a competitive but sustainable tax system so that investors can establish real, effective, and substantial businesses and not establish those businesses strictly for tax savings purposes in the source country.

The ability of a country to attract investments is strongly influenced by its stability and choices of economic policies, as well as by due process. The tax system is called on to meet those requirements as well, especially regarding taxation of corporations. The stability of rules over time and the certainty of provisions — also as far as interpretative positions taken by the tax authorities are concerned — are fundamental.

As of October 24, 2011, San Marino has entered into TIEAs with the countries listed in Table 1.

Table 1. San Marino's TIEAs

Country	Date Signed	Date Entered Into Force
Andorra	Sept. 21, 2009	Dec. 7, 2010
Argentina	Dec. 7, 2009	Not yet
Australia	Mar. 4, 2010	Jan. 11, 2011
Bahamas	Sept. 24, 2009	Not yet
Canada	Oct. 27, 2010	Oct. 20, 2011
Denmark	Jan. 12, 2010	May 19, 2010
Faroe Islands	Sept. 10, 2009	June 3, 2011
Finland	Jan. 12, 2010	May 15, 2010
France	Sept. 22, 2009	Sept. 2, 2010
Germany	June 21, 2010	Not yet
Greenland	Sept. 22, 2009	Not yet
Guernsey	Sept. 29, 2010	Mar. 16, 2011
Iceland	Jan. 12, 2010	Not yet
Monaco	July 29, 2009	May 10, 2010
Netherlands	Jan. 27, 2010	Not yet
Norway	Jan. 12, 2010	July 22, 2010
Samoa	Sept. 1, 2009	Not yet
South Africa	Mar. 10, 2011	Not yet
Spain	Sept. 6, 2010	Aug. 2, 2011
Sweden	Jan. 12, 2010	July 1, 2010
United Kingdom	Feb. 16, 2010	July 27, 2010
Vanuatu	May 19, 2011	Not yet

San Marino has entered into specific agreements on information exchange (based on article 26 of the OECD model) with the countries listed in Table 2.

Objectives of the Reform

In summary, the tax reform project has set the following goals:

Table 2. San Marino's Income Tax Treaties and Protocols

Country	Type	Date Signed	Entered Into Force
Austria	Protocol	Sept. 18, 2009	June 1, 2010
Belgium	Protocol	July 14, 2009	Not yet
Hungary	Treaty	Sept. 15, 2009	Dec. 3, 2010
Liechtenstein	Treaty	Sept. 23, 2009	Jan. 19, 2011
Luxembourg	Protocol	Sept. 18, 2009	Aug. 5, 2011
Malaysia	Treaty	Nov. 19, 2009	Dec. 28, 2010
Malta	Protocol	Sept. 10, 2009	Feb. 15, 2010
Portugal	Treaty	Nov. 18, 2010	Not yet
Romania	Protocol	July 27, 2010	June 16, 2011
St. Kitts and Nevis	Treaty	Apr. 20, 2010	Not yet

- *increase the tax revenue* by means of a radical and substantial revision of the provisions that regulate the determination of taxable income and of the current tax rates for corporations, employees and self-employed workers, and sole proprietorships;
- *apply greater taxation equity* by fully respecting the taxpaying capacity principle and protecting taxpayers in lower income brackets;
- *simplify the tax system* by streamlining it while keeping competitiveness and reducing the system's distortions and erosion phenomena of the taxable base;
- *foster San Marino's effective and substantial entrepreneurship* through rules and mechanisms to reward legal entities that, for example, invest in employment or research and development;
- *deter the creation and the operativity of "artificial" entities* to ensure the consistency and transparency of the San Marino tax system;
- *enact effective social policies* aimed at supporting families and the lower income brackets; and
- *align the San Marino tax regime* to well-established and commonly shared international standards, represented by transparency, cooperation, and fair tax competition.

Reform Guidelines for Corporate Income

The objective of the tax reform project is to streamline the corporate taxation system, reduce rates, and increase the tax base. Significant differences remain among EU countries regarding the determination of the taxable base, the level of tax rates, and the structure of the levy.

Enterprises must perceive a tax system that takes into account the needs of economic growth, competitiveness, and investments (including foreign ones).

It would be helpful to clarify the meaning of a tax system that takes into account the needs of economic growth, competitiveness, and investments. This phrase refers to the stability, reasonableness, and simplification of law, which affects the competitiveness of the country if it contributes to reducing the tax risks of enterprises.

The phrase has a second meaning, one that refers to a tax system that is capable of creating a favorable climate for enterprises intending to invest, by boosting the equity or technological know-how.

A third meaning of the phrase involves the tax reforms that have been planned and implemented in other member states. The recent tax competition in Europe (and at an international level as well) has been to attract business through lowering the corporate rate of taxation. In many countries — the smaller ones, in particular — the intention is to attract capital by reducing tax burdens and by offering privileged conditions for specific operations. In general, the crux of the debate is the increase of the taxable base (in some countries through the partial nondeductibility of payable interest) in order to reduce the tax rate.

Information Exchange Law

Fundamental Principles

As established by article 1 of the law on exchange of information, San Marino's parliament has been strengthening bilateral agreements in matters of tax cooperation through the signing of treaties and TIEAs based on OECD standards. The rules on the exchange of information have been based on the memorandum

of understanding model, approved by the OECD and by the European Council in 2001, as well as by article 8 of Directive 2011/16/EU of February 15, 2011.

Article 2 of the law regulates tax information exchange. Exchange of information also occurs according to provisions set forth under international agreements in force and with provisions of Decree-Law No. 36 of February 24, 2011. Of particular importance is the rule that states:

> while waiting for the conclusion and the entry into force of agreements between the San Marino Republic and other Countries or Jurisdictions to avoid double taxation and/or to promote the exchange of information on tax matters on the basis of OECD standards, the provisions of Title III define the procedures through which the Republic of San Marino provides tax information upon request to the said Countries or Jurisdictions with which the negotiated agreement, initialled in compliance with international Laws, has not yet entered into force.[4]

The exchange of information upon request is ensured not only for those countries with which the San Marino Republic has signed specific cooperation agreements on tax matters — and that are in force — but also for jurisdictions, such as Italy, with which specific agreements on the exchange of information have only been initialed.

When Agreements Are in Force

Title II of the law contains the rules for the exchange of information when the agreements are in force.

Article 4 sets forth that receipt of information requests and dispatch thereof by the competent authorities in San Marino is governed by reference to the OECD, particularly the ''Manual on the Implementation of Exchange of Information Provisions for Tax Purposes — Module 1 on Exchange of Information on Request,'' dated 2006.

The competent authority, the Ufficio Centrale di Collegamento (the Central Connection Office, or CCO), verifies the elements of a request by a contracting state by establishing whether the request is allowed under:

- the relevant bilateral agreement;
- the law under examination; and
- Decree-Law No. 36 of February 24, 2011.

If the request is valid and complete, the CCO collects and transmits the requested information.

If a request is incomplete or does not comply with treaty provisions or with the law at issue, the CCO must promptly inform the competent authorities of the requesting state in order for them to provide all supplementary information (article 5 of the law).

The law regulates in detail, and in line with OECD principles, all circumstances that might justify the CCO's refusal to exchange information. According to article 6, the request may be rejected in the case when:

- evidence is provided that the requesting state did not make use of all means available on its own territory to obtain that information (an exception is made when the use of those means might have caused unwarranted difficulties);
- the information exchange might be in contrast with public order;
- the request might not contain sufficient elements to prove the ''foreseeable relevance'' of the information being requested for application purposes of internal rules by the requesting state; or
- the request is not detailed enough or is considered to be a ''fishing expedition'' (meaning an indiscriminate attempt to obtain information).

Moreover, the CCO may not provide information that might:

- reveal business or industrial secrets, or any trade procedures;
- reveal private communications between a client and a lawyer, attorney-at-law, or other qualified legal representative when those communications have been produced for the purposes of the request or for the supply of legal consultancy services or for their use in court proceedings; or
- have been requested to enact one of the provisions of the tax legislation of the requesting state, which might be discriminatory against a San Marino citizen.

In short, the CCO is not compelled to provide information that is not kept by the San Marino authorities or held by or under the control of people or companies located in San Marino.

Initialed Agreements

Article 9 sets forth that the CCO must provide assistance to the competent authorities of the states with which the TIEA has been negotiated and initialed in compliance with international laws through the exchange of information that is ''foreseeably relevant'' to the application of the internal tax legislation. The information must be relevant to:

- the determination, assessment, and collection of taxes;
- the recovery and application of tax credits; and
- investigations and criminal proceedings involving tax matters.

For those states with which the agreement has only been initialed, the information exchange takes place in

[4] *See* article 2 of the Information Exchange Law.

compliance with legal provisions, regardless and irrespective of the set of rules contained by the agreement relating thereto that has not entered into force yet.

As far as the procedures for the dispatch of requests, article 11 establishes that the CCO provides, upon request, to the competent authority of the requesting state, whatever information is deemed ''foreseeably relevant'' to the application of internal tax laws. Moreover, the exchange occurs regardless of whether the behavior subject to investigation is deemed a criminal offense in accordance with San Marino laws, as long as that behavior occurred in the territory of San Marino.

As a routine practice, requests ought to be dispatched within 90 days from receipt. If their complexity requires a term that extends beyond 90 days, the CCO must promptly notify the competent authority of the requesting state.

As to the manner or form under which the requests are to be dispatched, article 11 provides that when expressly required, the CCO may provide information under ''the form of depositions by witnesses and authenticated copies of original documents.'' To determine the ''foreseeable relevance'' of the information, the request submitted by the requesting state must include the following:

a. the identity of the person under examination or inspection;

b. a declaration of the information requested, including the nature and manner in which the requesting party wishes to receive the information from the party to which the request was submitted;

c. the tax purpose for which the information is being requested;

d. the reasons for which it is deemed that the requested information may be found in San Marino, or that the information may be held or be under the control of a person who falls under the jurisdiction of San Marino;

e. to the extent to which these might be known, the names and addresses of each person deemed to be in possession of the requested information;

f. a declaration substantiating that the request is in compliance with the law and with the administrative procedures of the requesting state, and that if the requested information might have been found in the requesting state, then the competent authority of that state would have been able to obtain the information in accordance with its own laws or during the ordinary course of administrative procedures; and

g. a declaration proving that the requesting authority has employed all means available in its own territory to obtain the information, except for those means that might have caused unwarranted difficulties.

States intending to use any form of assistance must communicate through diplomatic channels with San Marino's Office of the Secretary of State for Foreign Affairs and must include the personal details of the competent authorities to initiate the request for assistance by providing any and all other information that may be useful in identifying the officers in charge with the said authorities.[5]

In line with the contents ratified by the TIEAs, concluded in accordance with OECD standards, the law requires that the state keep confidential the information that has been transmitted (article 12). ◆

[5]The Office of the Secretary of State for Foreign Affairs submits to the CCO a list of states for which the provisions on the exchange of information provided by law are applicable.